



HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

JORDAN

Developing Supervisory Review and Evaluation
Process SRP Framework

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High-Level Summary Technical Assistance Report Monetary and Capital Markets Department

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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: The International Monetary Fund (IMF)'s Middle East Regional Technical Assistance Center (METAC) is currently assisting the Central Bank of Jordan (CBJ) in enhancing its risk-based supervision through the development of a Supervisory Review and Evaluation SRP framework inspired from European Central Bank (ECB) methodology. The Technical Assistance (TA) mission is part of a multi-step medium-term project. The TA mission aimed to design, in coordination with CBJ, a progressive multi-step roadmap defining the major milestones for a full implementation of SRP. The mission noted that several dimensions should be taken into consideration when implementing the SRP, most notably bridging the data gap by building a fully-fledged supervisory risk database through a dedicated IT project, assessing whether the current organization of the Banking Supervisory Department should be adjusted, and progressively cover all material sources of risks in the SRP.

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Background

The Central Bank of Jordan (CBJ) is intending to enhance its risk-based supervisory framework, notably its risk rating framework inspired from EU Supervisory Review and Evaluation Process (SREP) and to move toward a risk-based supervision further.

The CBJ requested the International Monetary Fund (IMF)'s Middle East Regional Technical Assistance Center (METAC) technical assistance (TA) in developing its risk-based supervision framework in January 2022. Designed as a multi-step medium-term task, the project started with a workshop in July 2022 presenting the objectives, overall architecture, and detailed risk-by-risk analysis of the European SSM SREP, to provide CBJ with a precise example of implementation of the Basel framework's Supervisory Review Process (SRP).

Following the workshop, METAC conducted in November 2022 a TA mission with the aim to design, in coordination with CBJ's staff, a progressive multi-step roadmap defining the major milestones for a full SRP implementation.

The mission focused on the risk-rating framework and its related processes, which involved the following tasks:

- Discuss the scope and adequacy of the current risk analysis tools.
- Identify how the risk-rating framework can be leveraged upon the existing tools to develop SRP.
- Understand the Jordanian financial sector structure for proportionality considerations.
- Understand the processes for annual supervisory plans, the supervisory cycle, the decision making and corrective actions.
- Understand the current processes of SRP key tools (ICAAP /recovery plans/stress testing), and their coordination within a larger SRP framework.
- Discuss the organizational structure, resources allocation, and capacity to implement SRP.
- Discuss the adequacy of IT systems and technology to perform SRP assessment.
- Devise a roadmap on developing risk rating with defined milestones towards implementation of SRP.

Summary of Findings

While the current rating systems (CAMEL and ROCA¹) encompass the evaluation efforts of the different supervisory teams of the risks of individual banks (with a strong focus on credit risk),

¹ The CAMEL and ROCA systems aim at assigning a risk score to local domestic banks and foreign-owned banks operation in Jordan respectively, reflecting their financial soundness and sustainability. Documents produced by the CBJ as well as interviews with local staff indicate that the CAMEL and ROCA assessments are based on quantitative indicators and qualitative judgments by supervisors, and general guidance is given through specific methodological guides to ensure consistency of treatment. Final ratings are not anchored yet through a more defined framework based on quantitative assessment and/or comparison between peers.

their implementation relies on rather qualitative guidance with lack of quantitative risk indicators to anchor the rating.

Risk-based supervision (RBS) and SRP are very data-dependent. The current fragmentation of data sources complicates automatic compilation of risk indicators for the various blocks of SRP, calibrate the scoring system based on statistical methods, and enable peer comparisons.

Currently, the risk assessment is carried out mainly as part of the onsite missions, which focus (by construction) on several other issues. As the frequency and timing of onsite inspections is not necessarily aligned with that of the annual review of banks, a better integration of the SRP within offsite activities should be considered.

Summary of Recommendations

The SRP approach should be kept simple at first, proportionate to the size and main risks of the Jordanian banking sector as well as to the CBJ resources. It should leverage existing reporting and tools as much as possible, but also improve data availability and formalize guidelines for risk analysis (e.g., Interest Rate Risk in the Banking Book IRRBB).

Integration of stress testing results and ICAAP analysis can help achieve the forward-looking element of the SRP assessment. The CBJ should aim to design a matrix to establish a link between the main SRP scoring and a range of capital add-ons to the minimum Pillar 1 capital requirements.

When transitioning to SRP, the current qualitative scoring approach could be improved by i) reinforcing both the quantitative (scoring of risks through key indicators) and qualitative analysis (more detailed guidance through specific questionnaires), and ii) better linking the results of risk analysis to final scores, capital/liquidity requirements, and other supervisory measures.

Several dimensions should be considered when implementing the SRP, most notably bridging the data gap by building a fully-fledged supervisory risk database through a dedicated IT project, assessing whether the current organization of the Banking Supervisory Department should be adjusted, and progressively covering all material sources of risks in the SRP (e.g. IRRBB).

To maintain continuous monitoring of bank risks and implement a more risk-focused approach, the CBJ should ensure that responsibilities between offsite and onsite functions for the implementation of the SRP approach are clearly defined and well-articulated. The reorganization of the Banking Supervision Department could be revised accordingly, where necessary.